**STATE OF NEW HAMPSHIRE**
**BEFORE THE**
**PUBLIC UTILITIES COMMISSION**

Docket DE 04-177

**Public Service Company of New Hampshire**
**Transition and Default Service Rates – Return on Equity**

July 7, 2005

**MOTION OF**
**PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE**
**FOR**
**REHEARING OF ORDER NO. 24,473**

Pursuant to RSA 365:21, RSA 541:3 and Rule Puc 203.15, Public Service Company of New Hampshire ("PSNH" or the "Company") respectfully requests rehearing of the "Order Following Hearing Regarding Return on Equity", Order No. 24,473 (the "Order") dated June 8, 2005. PSNH asserts that the Order is incorrect, unlawful, unreasonable, unjust, arbitrary, and unconstitutional because its holding is based upon a mathematically incorrect implementation of the evidence; it sets a return on equity that is not commensurate with the returns on investments in other enterprises having corresponding risk; it fails to set a just and reasonable rate by its failure to include consideration of risks borne by the Company's investors and similarly fails to consider superior performance by PSNH in the operation and administration of its generation assets; contrary to the evidence of record it is based upon a single theoretical methodology which produces legally unacceptable results and fails to consider other reasonable methodologies; it is based upon extrinsic evidence and on calculations performed outside the record; and it demonstrates the Commission did not fulfill its statutory charge under RSA 363:17-a.

In support of this Motion for Rehearing, PSNH states:

**FACTUAL BACKGROUND**

1. This proceeding was intended to determine a reasonable and appropriate return on equity ("ROE") for PSNH's generation assets. The purpose of this proceeding was not to determine an ROE for PSNH as a vertically-integrated utility, nor a return for PSNH's distribution assets.

2. A two day adjudicative hearing took place in this proceeding. During this hearing, three witnesses presented testimony concerning the appropriate cost of equity capital for PSNH's generation assets. PSNH presented the expert testimony of Dr. Roger A. Morin; the Office of Consumer Advocate ("OCA") presented the expert testimony of Mr. Stephen A. Hill; and, Ms. Maureen Sirois of the Commission Staff presented her expert testimony.

    a. Dr. Morin was recognized by Commission Staff as being perhaps the foremost expert on estimating a regulated utility's cost of equity.[1] Dr. Morin has been routinely quoted and relied upon by the Commission for the past twenty years.[2] Dr. Morin, a professor at Georgia State University, has also taught at the Wharton School of Finance (University of Pennsylvania), the Amos Tuck School of Business (Dartmouth College) Drexel University, the University of Montreal and

[1] "Staff will stipulate that Roger Morin is one of the nation's foremost experts, if not the foremost expert, on estimating a regulated utility's cost of equity. After all, he wrote the book. He is, for our purposes, the smartest kid in the class." Transcript, Day II, p.211.

[2] *See, e.g., Re Manchester Gas Company*, 71 NHPUC 446, 473 (1986); *Re Kearsarge Telephone Co.,* 73 NHPUC 422, 423 (1988); *Re EnergyNorth Natural Gas Co.,* 76 NHPUC 690, 693-4 (1991); *Verizon New Hampshire*, __ NHPUC __ , 232 PUR 4th 24, (0rder No. 24,265) (2004).

McGill University. He has authored myriad books, articles, journals and monographs concerning the subject of utility finance, including the authoritative text referred to and relied upon by the Commission.[3] Dr. Morin has testified before regulatory bodies in 45 states and Canadian provinces, as well as before federal regulatory agencies. Dr. Morin's detailed résumé appears in Exhibit RAM-1 included in his pre-filed testimony (Exhibit 7).

b. Mr. Hill has testified before more than thirty state and federal regulatory agencies in over 220 regulatory proceedings. A detailed account of Mr. Hill's educational background and occupational experience appears in Appendix A of his pre-filed testimony (Exhibit 14).

3. In the Order, the Commission ruled that it would continue to rely solely upon a multi-stage discounted cash flow methodology ("DCF") for determination of the cost of equity capital for jurisdictional utilities including PSNH. The results of other methodologies were purportedly used as checks on the reasonableness of the initial DCF determination.

4. The DCF methodology requires the use of a proxy group of companies to assemble the data necessary to perform the analysis. Those proxy group companies were specifically chosen to be companies with risks similar to those of the utility in question, in this case PSNH.[4] The Order states that the proxy group assembled by OCA witness Hill was preferred by the Commission. Mr. Hill's proxy group contains twelve companies, all of which are either vertically-integrated electric utilities or electric distribution utilities (not solely generation companies).

[3] Staff witness Sirois testified that Dr. Morin's book was "one of the leading treatise, if not the leading treatise, on that particular subject, that an expert witness…would consult". Transcript, Day II, p. 66.

[4] The Order notes that one of the goals of a proxy group is "to reflect the risks faced by the company in question". Order at p. 36.

5. Using Mr. Hill's proxy group and data not included in the record evidence, subsequent to the close of the record the Commission calculated a new ROE for this proceeding. The mathematic result of that calculation was precisely 9.42%, which was adopted by the Commission to represent the cost of equity capital for a vertically-integrated electric utility.

6. Because the purpose of this proceeding was to determine the cost of equity capital for PSNH's generation business and not for its entire vertically-integrated enterprise, the Order notes that an adjustment to this 9.42% result was required. The Commission agreed with PSNH witness Dr. Roger A. Morin and OCA witness Mr. Hill that investors face more risk in the generation portion of the electric utility business than in the distribution (poles and wires) portion. Hence, the Order includes the addition of a generation risk premium to the vertically-integrated cost of equity capital. Adding this generation risk premium to the Commission's formulaically derived vertically integrated cost of capital of 9.42% resulted in the Order's final generation ROE for PSNH of 9.63%.

**<u>ISSUES REQUIRING REHEARING</u>**

7. The Order requires rehearing because the 9.63% cost of equity capital set forth therein is the result of a misinterpretation and misapplication of Dr. Morin's risk premium, therefore resulting in a mathematically incorrect result.

   a. The Commission agreed with PSNH witness Dr. Morin and OCA witness Mr. Hill that the generation segment of the electric utility business has more risks to investors than other components of the business.[5] To recognize these additional risks, the Commission found that a risk premium must be added to the cost of equity capital for a vertically integrated company to arrive at the proper ROE.

[5] *See also*, Exhibit 6, Extract of Testimony of Ben Johnson, Ph.D, before the Texas Public Utility Commission, in its Docket No. 22350, "In general, it is fair to say that most of the risks associated with the electric utility industry lie within the generating sector."

b. The Commission accepted a generation risk premium of 64 basis points (0.64%), which was the lowest point of the risk premium range contained in Dr. Morin's testimony. Order, p. 39-41. However, the Commission mistakenly added only one-third of this 64 basis points premium (21 basis points), based upon its off-the-record understanding that PSNH's state-jurisdictional rate base capital is composed of roughly one-third generation assets and two-thirds distribution assets. *Id.* Adding this 21 basis point generation risk premium to the vertically integrated cost of capital of 9.42% results in the Order's final generation ROE of 9.63%. *Id.*

c. As mathematically demonstrated below, the Order misinterprets and misapplies Dr. Morin's testimony, and therefore arrives at an arithmetically incorrect result. In addition, the Commission's assumed one-third / two-thirds split of its state-jurisdictional rate base between generation and distribution assets is not based upon evidence of record and is factually incorrect.

d. Dr. Morin discusses the generation risk premium recommendation at pages 79 to 80 of his testimony. (Exhibit 7). Dr. Morin testified that, "In summary, the estimates of the return differential between the T&D and the power generation businesses range from 64 to 86 basis points…." Thus, Dr. Morin's risk premium is expressly the differential between the wires portion of the business and the power generation portion of the business.

e. The use of one-third of Dr. Morin's recommendation as the risk premium to be added to the 9.42% base cost of capital for a vertically-integrated company produces mathematically incorrect results. Using the Order's assumption that PSNH's state-jurisdictional capital assets are roughly one-third generation related and two-thirds distribution related, then the weighted vertically-integrated ROE for PSNH would be determined using the formula:

$$ROE_{VI} = 1/3\ ROE_G + 2/3\ ROE_D$$

Where: $ROE_{VI}$ = Vertically Integrated ROE

$ROE_G$ = Generation ROE

$ROE_D$ = Distribution ROE

Using the figures in the Order, since $ROE_G = 9.63$, then the $ROE_D$ would be 64 basis points lower, or 8.99.

These two ROE's would result in a vertically-integrated ROE of:

$$ROE_{VI} = 1/3\ ROE_G + 2/3\ ROE_D = 1/3\ (9.63) + 2/3\ (8.99) = 9.20\%$$

This result of 9.20% should, but <u>does not</u>, equal the base vertically integrated ROE set forth in the Order of 9.42%. Thus, the use of only one-third of Dr. Morin's recommended risk premium is mathematically incorrect.

f. The correct implementation of the recommended risk premium, using the Order's determination of a vertically integrated cost of capital of 9.42%, the 1/3 – 2/3 G versus D weighting, and Dr. Morin's 64 basis point risk premium spread between $ROE_G$ and $ROE_D$ is as follows:

$$ROE_{VI} = 1/3\ ROE_G + 2/3\ ROE_D$$

$ROE_G - ROE_D = 0.64$ Therefore, $ROE_D = ROE_G - 0.64$

Substituting,

$$ROE_{VI} = 1/3\ ROE_G + 2/3\ ROE_D = 9.42 = 1/3\ ROE_G + 2/3\ (ROE_G - 0.64)$$

Solving the equation,

$ROE_G = 9.85\%$ (and, the resulting $ROE_D = 9.21\%$)

g. Moreover, the Commission's one-third / two-thirds weightings are not included in the evidence of record for this proceeding and are incorrect. PSNH's generation rate base actually comprises 28% of PSNH's state-jurisdictional rate base assets.[6] Replacing the 1/3 – 2/3 G versus D weighting with the Company's actual 0.28 – 0.72 weighting, results in a ROE for PSNH's generating assets of 9.88%

h. As demonstrated above, using the Commission's analysis set forth in the Order with correct Company data, and using the Order's 9.42% ROE for a vertically-integrated company, the mathematically correct ROE for PSNH's generation business would be 9.88%. Thus, rehearing of the Order is required to allow this mathematical error to be corrected by the use of a 46 basis point risk premium to reflect the additional risks inherent in PSNH's generation business.[7]

i. Even when the Commission corrects its $ROE_G$ determination to 9.88%, as discussed below, that result still remains unreasonable, unjust, arbitrary and unlawful, because the base figure of 9.42% is improper.

8. The Order requires rehearing because the cost of equity capital established therein is confiscatory as it fails to meet the Constitutional standard requiring a rate "commensurate with returns on investments in other enterprises having corresponding risks." [8]

a. The record evidence and decisions of the United States and the State of New Hampshire Supreme Courts are rife with citations to the Constitutional

[6] "PSNH Rate Base by Segment," NHPUC Docket No. DE 03-200, Testimony of Baumann/Canyock, Schedule 3, P. 3.

[7] The 46 basis point generation risk premium is calculated by multiplying the 64 basis point figure adopted from Dr. Morin's testimony by the Company's actual 28% / 72% generation / distribution asset mix.

[8] "Commensurate": Equal in measurement or extent. *Merriam Webster's Collegiate Dictionary*, 10th Ed., 1997.

requirement that a just and reasonable return on equity is one that is "commensurate with returns on investments in other enterprises having corresponding risks." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *New Eng. Tel. & Tel. Co.* v. *State*, 95 N.H. 353, 361 (1949), Testimony of Maureen Sirois, Exhibit 17 at 1-2;[9] Testimony of Stephen G. Hill, Exhibit 14 at 5;[10] Testimony of Dr. Roger Morin, Exhibit 7, at 8-10. The Order itself clearly states this Constitutionally-based standard: "[T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks . . . . [and] sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." Order at p. 33, citing to *Hope* at 320 U.S. at 603.

b. Past Commission decisions also correctly note this standard. For example, in *Re Concord Electric Company*, 63 NHPUC 240 (1978), the Commission held, "…we are guided by the principles of the Bluefield Water Works & Improv. Co. v West Virginia Pub. Service Commission, 262 US 679, and Federal Power Commission v Hope Nat. Gas Co. (1944) 320 US 591 which both emphasize a return 'commensurate with returns of investments in other ***enterprises having corresponding risk***,' 320 US 591, 603." 63 NHPUC at 244 (emphasis in original). That same year in *Re Public Service Company of New Hampshire*, 63 NHPUC 127 (1978), the Commission correctly stated, "[Commission witness] Trawicki makes comparisons not only with other regulated industries but with

[9] "The purpose of my testimony is to provide, for transition energy service rate making purposes, a rate of return on equity recommendation for Public Service Company of New Hampshire's (PSNH or the Company) generation assets according to the standards set forth in *Bluefield Water Works v. PSC*, 262 U.S. 679, 692-93 (1923) (*Bluefield*) and *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) (*Hope*). In *Hope* and *Bluefield*, the U.S. Supreme Court set the standard that a public utility may be allowed to earn a return comparable to a return on investments in other enterprises having similar risks that allows the utility the opportunity to attract capital and to maintain its credit. In *Conservation Law Foundation of New England, Inc. v. Consumer Advocate*, 127 N.H. 606, 507 A.2d 652, the New Hampshire Supreme Court supports the basic principle that a utility has the opportunity to make a profit on its investment."

[10] "The Supreme Court of the United States has established, as a guide to assessing an appropriate level of profitability for regulated operations, that investors in such firms are to be given an opportunity to earn returns that are sufficient to attract capital and are comparable to returns investors would expect in the unregulated sector for assuming the same degree of risk. The Bluefield and Hope cases provide the seminal decisions [Bluefield Water Works v. PSC, 262 US 679 (1923); FPC v. Hope Natural Gas Company, 320 US 591 (1944)]."

nonregulated industries having comparable or corresponding characteristics. ***This method is supported by the economic criteria laid down in the two United States Supreme Court decisions (Bluefield and Hope) which hold that rate of return for a utility company should be commensurate with returns being earned on investments with companies with corresponding risks***." 63 NHPUC at 156 (emphasis added).

The Commission has also recognized that a return commensurate with firms of similar risk is not just a principle that can be accepted or rejected, but is a Constitutional entitlement:

> As was cited and accepted by both Parties and the Staff, ***a utility is constitutionally entitled to an opportunity to realize a return on its investment equivalent to firms of similar risk*** and sufficient to attract capital in the prevailing markets, but not so high as to be speculative. *Bluefield Water Works and Improvement v. Public Service Commission*, 26[2] U.S. 679, 672 (1923); *Federal Power Commission v. Hope*, 320 U.S. 591 (1944).

*Re EnergyNorth Natural Gas, Inc.*, 78 NHPUC 117, 121 (1993) (emphasis added).

c. In its heretofore most recent decision on cost of capital, the Commission stated that, "The most comprehensive review of the New Hampshire law on cost of capital may be found in *Appeal of Conservation Law Foundation*, 127 N.H. 606, 633 *et seq.* (1986)." *Verizon New Hampshire,* 232 PUR 4th 24, Docket No. DT 02-110, Order No. 24,265 (January 16, 2004), *slip op* (hereinafter *Verizon*) at 40. In the *Appeal of Conservation Law Foundation* (hereinafter *CLF)* decision, the New Hampshire Supreme Court held:

> Subject to the qualifications that follow, the commission should set a rate sufficient to yield a return comparable "to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties [.]" *Bluefield Co. v. Pub. Serv. Comm.*, 262 U.S. 679, 692 (1923); *New England Tel. & Tel. Co. v. State,* 113 N.H. 92, 95, 302 A.2d 814, 817 (1973); *New Eng. Tel. & Tel. Co. v. State*, 104 N.H. at 234, 183 A.2d at 241; *New Eng. Tel. & Tel. Co. v. State*, 98 N.H. at 221, 97 A.2d at 221; *Chicopee Mfg. Co. v. Company*, 98 N.H. 5, 13, 93 A.2d 820,

826 (1953), *overruled on other grounds*, 119 N.H. 359, 366, 402 A.2d 644, 649 (1979); C. PHILLIPS, JR., *supra* at 339.

*CLF* at 635.

d. The record evidence clearly and unequivocally proves that a return of 9.63% is not commensurate with returns being earned on investments in companies with corresponding risks. In fact, the record evidence specifically sets forth dozens of allowed returns on equity for vertically-integrated electric utilities or distribution electric utilities, and every single one of them is higher than the 9.63% return on equity established by the Order. (*See*, Exhibits 16, 20, 21).

e. It is important to note the companies set forth in Exhibits 16 and 20, as they were specifically chosen by Commission Staff Witness Sirois or OCA Witness Hill to be companies with risks comparable to that of PSNH. Testimony of Sirois, Transcript, Day II, p. 73; Testimony of Hill, Transcript, Day II, p. 6. Every single company chosen by witnesses Sirois and Hill as companies having risks comparable to that of PSNH have allowed returns on equity capital above 9.63%.[11] The average ROE allowed for these companies is 11.34%. The fact that the return established in the Order is less than that of every one of those companies chosen by Staff and OCA as representative of companies with similar risk to that of PSNH is unequivocal evidence that the Commission's

[11] Exhibits 16 and 20 list the following companies included in the proxy groups assembled by the Staff and OCA witnesses and the returns on equity allowed by their regulators for their vertically-integrated or distribution operations:

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|---|---|---|---|---|
| Central Vermont Public Service | 10.00% | | First Energy | 12.2% |
| Progress Energy | 12.75% | | Ameren | 11.07% |
| Cinergy | 11.00% | | CLECO | 12.25% |
| Entergy | 11.19% | | Hawaiian Electric | 11.22% |
| PNM Resources | 10.25% | | Pinnacle West | 11.25% |
| Florida Power & Light | 12.8% | | Green Mountain Power | 10.5% |
| PPL Corp. | 10.70% | | Southern Co. | 11.25% |
| MGE Energy | 12.00% | | Empire District Electric* | 11.00% |

*ROE for Empire District Electric obtained from Exhibit 21.

formulaically-derived 9.63% decision is terribly wrong. Aggravating this error even further, the Commission acknowledges in the Order that PSNH's generation business segment is riskier than the vertically-integrated or distribution electric utilities contained in the two proxy groups, thus requiring a premium over and above the returns being earned by the proxy group companies. This exacerbates the Order's departure from the Constitutional standard. Hence, the Commission's 9.63% figure is clearly arbitrary, unjust, unreasonable, and unconstitutional as it is lower than the ROE's contained in the record evidence allowed by every other utility regulatory commission across the United States for distribution or vertically-integrated utilities of commensurate risk.

f. All the most recent decisions by other regulatory commissions across the country unequivocally demonstrate that the 9.63% figure fails to meet the Constitutional requirement set forth by the *Bluefield* and *Hope* line of cases. Exhibit 21 contains a listing of the cost of equity capital allowed by regulatory commissions in South Carolina, Kansas, Washington, Utah, Missouri, Arizona, Vermont, and Texas during the first quarter of 2005 for distribution or vertically-integrated electric utilities. Every single one of these regulatory agencies recently ruled that the cost of capital for their distribution or vertically-integrated utilities was 10.0% or higher. The ROEs granted to these companies for the first quarter of 2005 ranged from 10.0% to 11.0%, with an average of 10.44%. An ROE of 9.63% for a generation business is simply arbitrary, unjust, unreasonable, and unconstitutional as it is not commensurate with returns of investments in other enterprises having corresponding risk.

g. Perhaps the best example of why the 9.63% return on equity is unreasonable is the comparison of this return with Federal Energy Regulatory Commission ("FERC")-regulated "reliability must run" ("RMR") generating plants.[12] Dr. Morin testified that these RMR plants are a "pure-play" proxy for PSNH's generating business. Dr. Morin explained that "A 'pure-play' is a publicly traded

[12] *See,* Transcript, Day I, p. 106

company that is in the same business as whatever entity you're trying to assess….'Pure-plays' mean 'similarity of risks' that are publicly traded ." Transcript, Day I, p. 125. Dr. Morin testified that the New England-based FERC-regulated RMR plants represent "the best pure-play to PSNH's generation activities. And, of course, the authorized rate of return on those assets is 10.88. And, that's as close as you can get to the purpose at hand here, which is to set an ROE for the generation assets of PSNH." Transcript, Day II, p. 153. When asked by NHPUC Staff Counsel, "Do you have an opinion about the relative risk of PSNH's generation portfolio and the reliability must-run plants that exist in New England?" Dr. Morin responded, "I think they're comparable." Finally, Dr. Morin observed that, "An investor looking at an investment in the RMR plants, with a 10.88 percent return, versus an investment in PSNH, at Staff's or OCA's recommendation, has a very easy decision to make." As a result of the Order, that investment decision is equally easy –PSNH will have difficulty attracting equity capital with a return of 9.63% when FERC is allowing a return of 10.88% on equity capital invested in rate-regulated generating assets also located within New England and also connected to the ISO-NE transmission system.[13] Once again, the FERC-allowed return on equity of 10.88% for generation assets located in New England demonstrates that an ROE of 9.63% for PSNH's generation business is simply arbitrary, unjust, and unreasonable, and not commensurate with returns on investments in other enterprises having corresponding risk.

h. Instead of using the constitutional standard of ensuring that the Order's return on equity is commensurate with returns on investments in other enterprises having corresponding risk, the Commission used markedly different bases of comparison. Ignoring the actual, allowed ROEs of 10.25%, 12.2%, 12.75%, 11.07%, 11.00%, 12.25%, 11.19%, 11.22%, 10.25%, and 11.25% for the companies of commensurate risk contained in the Commission-preferred proxy group of OCA

[13] The ability to attract equity capital is one of the fundamental requirements of a compensatory cost of capital. *New Eng. Tel. & Tel. Co.* v. *State*, 95 N.H. 353, 361 (1949); *Appeal of Public Service Co. of New Hampshire,* 130 N.H. 748, 751 (1988); *Chicopee Mfg. Co. v. Public Service Co. of New Hampshire*, 98 N.H. 5 (1953); *New England Tel. & Tel. Co.* v. *State*, 113 N.H. 92, 95 (1973)

witness Hill,[14] the Order justifies its 9.63% determination based upon anecdotal comparisons. Reliance upon a letter to the editor appearing in a trade journal, Northeast Utilities' conservative assessment to its investors of returns on equity it is likely to receive from regulatory agencies (particularly in an environment where unfulfilled overly optimistic forecasts run the risk of shareholder litigation), and an increase in parent company NU's dividend to shareholders is just plain wrong as demonstrated by the resulting decision not even close to being commensurate with the returns being received by companies with similar risks.[15]

9. The Order requires rehearing because the decision is unjust, arbitrary, and unreasonable as it is not a just and reasonable rate as required by the Constitution, by statute and by decisions of the United States and New Hampshire Supreme Courts, and it falls outside of the "zone of reasonableness" established by past Court and Commission decisions.

a. The New Hampshire Supreme Court has recognized that a "just and reasonable" return, as required by RSA 378:7, 378:27 and 378:28, requires "the exercise of a fair and enlightened judgment, having regard to all relevant facts." *New England Telephone & Telegraph Co. v. State,* 104 N.H. 229, 234 (1962) (citing to *Bluefield, New England Telephone & Telegraph Co.*, 95 N.H. 353 (1949), and *Chicopee Mfg. Co.* v. *PSNH,* 98 N.H. 5 (1953)). In the *New Eng. Tel. & Tel. Co.* case, the Court indicated:

> Just and reasonable rates is the touchstone by which the Commission was to assay the company's rates and charges prevailing when it ordered its investigation and the standard by which it was to order and fix new rates. RSA 378:7, 27, 28. *New Eng. Tel. & Tel. Co.* v. *State*, 95 N.H. 353, 356; *New Eng. Tel. & Tel. Co.* v. *State*, 98 N.H. 211, 218; *Federal Power Com.* v. *Hope Gas Co.*, 320 U. S. 591, 602. "The proper rate of return is a matter for the judgment of the Commission, based upon the evidence before it. In fixing the rate the cost of capital may not be ignored;

[14] Exhibit 16, excluding Northeast Utilities for the reasons discussed in the Order at fn. 4, p. 37. The average return on equity capital awarded to these companies selected to have risks commensurate to that of PSNH is 11.343%.

[15] Order at 43.

> but what that cost may be is also a matter for determination by the Commission upon the evidence. ... ***Once determined, it marks the minimum rate of return to which the company is lawfully entitled."*** *New Eng. Tel. & Tel. Co.* v. *State, supra*, 95 N.H. 353, 361. However in accordance with the statutory directive that rates must be "just and reasonable" (RSA 378:7, 27, 28), the Commission in the exercise of its judgment on the evidence before it can allow a rate of return in excess of the cost of capital. *Chicopee Mfg. Co.* v. *Company*, 98 N.H. 5, 13.
>
> It is therefore apparent that there is more than one rate that may be a just and reasonable rate of return. The area between the lowest rate that is not confiscatory and the highest rate that is not excessive and extortionate has been referred to as a zone of reasonableness. *Banton* v. *Belt Line Ry.*, 268 U. S. 413, 423; *Atlantic Coast Line* v. *Florida*, 295 U. S. 301, 317; *Wisconsin Telephone Co.* v. *Public Service Comm.*, 232 Wis. 274, 329;
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> *Michigan Bell Telephone Co.* v. *Public Service Commission*, 332 Mich. 7, 26.

104 N.H. at 232, (emphasis added).

b. The Commission discussed this "zone of reasonableness" in its 2004 *Verizon* Order by first quoting from the N.H. Supreme Court's *Appeal of CLF* decision:

> The Commission is bound to set a rate of return that falls within the zone of reasonableness, neither so low as to result in a confiscation of company property, nor so high as to result in extortionate charges to customers.

*Id.* at 635, citing *Legislative Utilities Consumers' Council v. Public Serv. Co. of NH*, 119 N.H. 332, 341-42 (1979). (*Verizon* at 40).

The Commission continued its discussion of this standard in the *Verizon* Order:

> The Court further noted that the lower boundary of the zone of reasonableness should be a rate that, at a minimum, is sufficient to "yield the cost of the debt and equity capital necessary to provide the assets required for the company's responsibility."

*Id.*

The Commission's *Verizon* Order then goes on to discuss the upper boundary of the "zone of reasonableness":

> Subject to exceptions permitting the Commission to assume a hypothetical capital structure and to make allowances for the relative efficiency of management, *see id.* at 635-636, the upper boundary is a rate "sufficient to yield a return 'comparable to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.'" *Id.* at 635 (citing *Bluefield*, 262 U.S. at 692, *New England Tel. & Tel. Co. v. State*, 113 N.H. 92, 95 (1973) and other authorities).

*Verizon* at 41.

However, the Commission's discussion of the upper boundary completely mischaracterizes the law as described in the Supreme Court's *Appeal of CLF* decision. The error contained in the Commission's *Verizon* decision is that the New Hampshire Supreme Court <u>never made the statement attributed to it!</u> The Court <u>did not</u> hold in the *Appeal of CLF* case <u>and has never held</u> that the "upper boundary" of the zone of reasonableness is a rate "sufficient to yield a return 'comparable to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.'" In the cited *Appeal of CLF* decision, the Court only stated the upper end of the "zone of reasonableness" should not be so "high as to result in extortionate charges to customers." *Appeal of CLF* at 635.[16]

There is good reason why the New Hampshire Supreme Court never set a return comparable to that of companies with similar risks as the high end of the zone of reasonableness. The reason why such a return comparable to that of companies with similar risks <u>cannot</u> be the ceiling on the zone of reasonableness is readily apparent - - that is because a utility's entitlement to such a return is a "well

[16] Where then is the upper end of the zone of reasonableness? The N.H. Supreme Court has stated that the upper limit is reached when rates are "extortionate" (as cited above) or exploitative. *Appeal of Public Service Co. of New Hampshire,* 130 N.H. 748, 750; Petition of Public Service Co. of New Hampshire, 130 N.H. 265, 274-5 (1988). It is questionable whether the upper end of the zone of reasonableness is relevant to this proceeding, in that retail customers have the ability to choose a competitive supplier for their electric energy needs in lieu of purchasing transition or default energy service from PSNH if the energy rate charged by PSNH ever approached the level of being "excessive" or "extortionate."

established constitutional requirement." *New England Tel. & Tel. Co. v. State*, 113 N.H. 92, 95 (1973). The Court, quoting from *Bluefield*, indicated, "A public utility is ***entitled*** to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties;…" *State v. Hampton Water Works Co.*, 91 N.H. 278, 294 (1941) (emphasis added). Since a utility has a Constitutional entitlement to receive a return comparable to investments with corresponding risks, any return lower than this would not pass Constitutional muster. Hence, a "comparable return" must therefore be the <u>lower</u> end of the zone of reasonableness (since no lower return would be lawful), and not the upper end as erroneously stated in the *Verizon* decision.

c. By setting an ROE below that of every other company identified by the Commission Staff and OCA witnesses as companies with comparable risks, the Order sets PSNH's allowed return on equity for its generating business below the lowest end of the Court's "zone of reasonableness." The New Hampshire Supreme Court has noted, "Since our statutes do not provide a formula to be followed by the Commission in determining what are just and reasonable rates, we are not warranted in rejecting the method employed by it ***unless it plainly contravenes the statutory scheme of regulation or violates our law in some other respect***. *New Eng. Tel. & Tel. Co.* v. *State, supra*, 219; *Federal Power Com.* v. *Nat. Gas Pipeline Co.*, 315 U. S. 575, 585." *New England Telephone & Telegraph Co. v. State, 104 N.H* at 234, (emphasis added). The method endorsed by the Commission in the Order (the three-stage DCF methodology) produced a result that plainly contravenes the Constitutional requirement that a regulated utility is entitled to a return "commensurate with returns on investments in other enterprises having corresponding risks."

d. The New Hampshire Supreme Court has noted that a utility is entitled to a return not <u>at</u> the cost of money, but one that is <u>greater</u> than the cost of money:

> If a utility is to function effectively, this normally requires that the rate of return should be greater than the cost of money. … "The spread between the rate of return and the cost of money allowed above should be sufficient to absorb embedded costs, to maintain confidence in the financial soundness of the company, under efficient and economic management, and to enable the company to attract the capital necessary to discharge its obligations to its investors and consumers. This rate of return is over and above operating expenses, depreciation and taxes." While it is true that an attractive return to the investor is not necessarily just to the consumer (*Federal Power Commission* v. *Pipeline Co.*, 315 U. S. 575), a balancing of the interests of both investor and consumer requires a return which will enable the utility to maintain its credit and attract the necessary capital to meet increased demands for improvement and extension of its service. *Colorado Interstate Co.* v. *Federal Power Commission*, 324 U. S. 581.

*Chicopee Mfg. Co. v. Public Service Co. of New Hampshire*, 98 N.H. 5, 11 (1953).

The Commission's Order, which unsuccessfully attempted to set the rate of return <u>at</u> the mathematically calculated cost of capital, violates this Supreme Court directive.

e. Perhaps due to the erroneous Commission analysis of the zone of reasonableness contained in the *Verizon* decision, the Commission failed to consider where within the zone a "just and reasonable" rate should be set. There are many factors which evidence that PSNH is entitled to a return toward the upper-end of the zone of reasonableness in order to account for management efficiencies and its superlative stewarding of its generating business. In the 1962 *New England Telephone & Telegraph* case, the N.H. Supreme Court referred to a bonus on the cost of capital awarded by the Commission for that company's "record of achievement and the efficiency of its management." 104 N.H. 239, citing to *Missouri S. W. Bell T. Co.* v. *Public Serv. Com.*, 262 U. S. 276, 291. Similarly in *Public Service Co. of New Hampshire*, 69 NHPUC 67, 98-9 (1984), the Commission, referring to *Bluefield*, noted, "There can also be no question that the Commission has the constitutional authority to evaluate management efficiency when it sets an allowed return." The Commission continued, "…management efficiency is a factor to be considered is setting an appropriate rate of return. See also, *Providence Gas Co. v Burman* (1977) 119 RI 178, 22 PUR4th 103, 113, 376 A2d 687; *Re New England Teleph. & Teleg. Co*. (1949) 115 Vt 494, 79 PUR NS 508, 525, 66 A2d 135." In the *Appeal of CLF* case at 127 N.H. 635, the Court unambiguously stated, "the commission has authority to recognize the efficiency or inefficiency of a management when it sets the rate of return within the zone of reasonableness. *New England Tel. & Tel. Co. v. State*, 104 N.H. 229, 239, 183 A.2d 237, 244 (1962) (citing *S.W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276, 291 (1923) (Brandeis, J., concurring)). Professor Bonbright, in his landmark treatise, "Principles of Public Utility Rates," agrees, as he has stated, "[T]he amount of the allowed return may be designed, not just to enable a company to attract capital but also to reward efficiency and discourage inefficiency of management."[17]

f. Rather than reward PSNH for good and efficient management, the Order actually punishes the Company for its success. The Order states that because the Company has a record of avoiding imprudence findings and the concomitant disallowances of recovery of associated costs, PSNH's generation business faces less risk than is normally the case for generation investments of vertically integrated electric utilities. Order, p. 40. Therefore, when determining the appropriate risk premium to add to account for the risks of operating a generating business, the Commission chose the absolute bottom of the range endorsed by Dr. Morin. *Id.* Staff witness Sirois was asked whether the fact that PSNH has not been subject to materially large prudence disallowances in the recent past is more reflective of the fact that there is no risk of such disallowances or is it more appropriately attributed to the fact that PSNH has done a good job of operating its generation fleet - - her response was, ***"I would say that PSNH has done a good job,"*** Transcript, Day II, p. 93 (emphasis added). Instead of compensating PSNH for the risk the Company faces in the operation of its generating assets, and further compensating PSNH for the "good job" it has done on behalf of its customers, the Commission's Order

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[17] James C. Bonbright, Principles of Public Utility Regulation (1961) at 153.

does neither! The good management exhibited by the successful operation of its generating assets has resulted in a <u>decrease</u> in the return on equity instead of an increase. PSNH's record of superior generating performance is plainly demonstrated by the comparatively low cost of energy to PSNH's retail customers. PSNH's management has gone above-and-beyond the minimum standards by, *inter alia*, pursuing legislative changes needed to move forward with the Northern Wood Power Project; by taking risks such as beginning construction of that Project while a Supreme Court challenge was pending; by using below-the-line shareholder dollars to aggressively lobby the legislature not to pass unrealistic and uneconomic emissions reductions which would hurt retail energy costs; by challenging draconian water quality limitations in the relicensing of the Merrimack Hydro Project resulting in more reasonable conditions and lower costs to retail consumers. Yet, the Commission's Order wrongfully does not recognize any of these measures in its determination of a just and reasonable rate.

g. "It is an established rule that the utility is entitled to a minimum rate of return equal to the cost of capital. *Pennichuck Water Works v. State*, 103 N.H. 49, 52, 164 A.2d 669, 671 (1960); *Company v. State*, 95 N.H. 353, 361, 64 A.2d 9, 16 (1949). How much more than this will be allowed as a rate of return is a matter to be determined by the commission on the basis of what is 'just and reasonable.' *Chicopee Mfg. Co. v. Company*, 98 N.H. 5, 13, 93 A.2d 820, 825--26 (1953)." *Windham Estates Assoc. v. State*, 117 N.H. 419, 426 (1977). The Commission's Order fails to heed this "established rule" by awarding what it determined to be the minimum Constitutionally-required rate of return and ignoring the statutory "just and reasonable" standards.

h. The Commission's failure to consider PSNH's superlative management of its generating assets and its shareholders' dedication of below-the-line funds to protect the interests of retail customers results in a decision that is arbitrary, unjust and unreasonable. Moreover, it provides significant disincentives to the Company's management from taking future risks or future expenditures with shareholder dollars if such exemplary measures are viewed with indifference by the Commission. By failing to recognize the efficiency of PSNH management and by mischaracterizing the comparable return standard as the maximum legal return rather than the minimum, the Commission has destroyed the concept of the "zone of reasonableness" and has collapsed it to a single, arbitrary point.

10. The Order produces an arbitrary, unjust and unreasonable result because it relies upon one particular methodology to formulaically calculate the rate contrary to the testimony of OCA witness Hill, PSNH witness Dr. Morin, the recommendations of the Society of Utility and Regulatory Financial Analysts,[18] the practice of the majority of utility regulators across the United States, and past decisions of the New Hampshire Supreme Court.

a. The Order states, "To determine a rate of return on equity we must select a methodology. The primary method used by this Commission to estimate the expected return on equity has been the DCF model. See Order No. 24,265 (January 16, 2004). There are other valid methods as well, and this Commission has recognized that such methods may be used as a test of reasonableness to compare to the DCF result." Order at 34. The Commission rejected expert testimony explaining that use of one singular methodology was incorrect: "Inasmuch as we often look to other methodologies as a test of reasonableness of the DCF, we do not find a sufficient basis to depart from precedent in our approach in this proceeding." Order at 35.

b. During the course of this proceeding, three witnesses testified. The two most experienced witnesses both expressed their professional opinions that reliance upon one particular methodology to determine the appropriate return on equity for a regulated utility was improper. Dr. Morin was asked why use of more than one approach for estimating the cost of equity should be used. He responded:

> No one individual method provides the necessary level of precision for determining a fair return, but each method provides useful

[18] The "Society of Utility and Regulatory Financial Analysts" was formerly called the "Rate of Return Analysts Society." Transcript, Day II, p. 45-6.

> evidence to facilitate the exercise of an informed judgment. Reliance on any single method or preset formula is inappropriate when dealing with investor expectations because of possible measurement errors and vagaries in individual companies' market data. Examples of such vagaries include dividend suspension, insufficient or unrepresentative historical data due a recent merger, impending merger or acquisition, and a new corporate identity due to restructuring activities. The advantage of using several different approaches is that the results of each one can be used to check the others.
>
> As a general proposition, it is extremely dangerous to rely on only one generic methodology to estimate equity costs. The difficulty is compounded when only one variant of that methodology is employed. It is compounded even further when that one methodology is applied to a single company. Hence, several methodologies applied to several comparable risk companies should be employed to estimate the cost of capital.

In his pre-filed testimony, Dr. Morin provided a detailed, scholarly explanation of why reliance upon one single methodology to estimate a company's cost of equity capital is incorrect. (Exhibit 7, pp. 14-21). Dr. Morin cites to other recognized experts, including Professors Brigham and Gapenski,[19] Professor Myers,[20] and Dr. Phillips.[21] In his pre-filed testimony, Dr. Morin provided the following summary of his expert view on this matter:

> There is no single model that conclusively determines or estimates the expected return for an individual firm. Each methodology has its own way of examining investor behavior, its own premises, and its own set of simplifications of reality. Investors do not necessarily subscribe to any one method, nor does the stock price reflect the application of any one single method by the price-setting investor. Absent any hard evidence as to which method outperforms the other, all relevant evidence should be used, without discounting the value of any results, in order to minimize

[19] Exhibit 7 at 17-18.

[20] *Id.* at 18.

[21] *Id.* at 19. Notably, Dr. Phillips has repeatedly been relied upon as an authority in utility ratemaking matters by the New Hampshire Supreme Court. *See, e.g., Appeal of Public Service Co. of New Hampshire*, 130 N.H. 748, 751 (1988); *Appeal of Conservation Law Foundation of New England Inc*., 127 N.H. 606, 635 (1986); A*ppeal of Gary McCool and Roger Easton*, 128 N.H. 124, 140 (1986); *Appeal of Richards*, 134 N.H. 148, 160 (1991).

> judgmental error, measurement error, and conceptual infirmities. I submit that a regulatory body should rely on the results of a variety of methods applied to a variety of comparable groups. There is no guarantee that a single DCF result is necessarily the ideal predictor of the stock price and of the cost of equity reflected in that price, just as there is no guarantee that a single CAPM or Risk Premium result constitutes the perfect explanation of that stock price or the cost of equity

c. Likewise, OCA witness Mr. Hill concurred that it is necessary to use multiple methodologies to accurately estimate a utility's cost of equity capital. When asked, "What methodologies did you use to estimate the cost of equity capital in this proceeding?" Mr. Hill testified, "I used four. Dr. Morin and I are also in agreement that you should use more than one methodology." He later re-emphasized this topic when he testified:

> I agree with the premise that Mr. Eagle showed me in the manual, you should use multiple methodologies. I have never relied solely on the DCF, and I never will. I don't believe that any methodology is infallible. All these methodologies are estimates. I recognize all of that. And, I use multiple methodologies when I estimate the cost of capital, and I always have.

d. The Society of Utility and Regulatory Financial Analysts, the professional organization that awards the professional designation as "Certified Rate of Return Analyst,"[22] also admonishes its members that use of one single methodology to estimate a utility's cost of equity is improper. According to that Society's training manual, "no single model is so inherently precise that it can be relied on solely to the exclusion of all other theoretically sound models." Transcript, Day I, p.171. And, that Society's training manual also states, "Investors clearly do not subscribe to any singular method, nor does the stock price reflect the application of any one single method by investors." *Id.*

e. The New Hampshire Supreme Court concurs with the expert opinions expressed by Dr. Morin, Mr. Hill, and the Society of Utility and Regulatory Financial

[22] Transcript, Day I, p. 66-7.

Analysts. The Court has held that, "[r]ate-making cannot be reduced to an exact science by which a mathematically precise rate of return can be produced by a competently programmed computer," *Legislative Utility Consumers' Council v. Granite State Electric Co.*, 119 N.H. 359 (1979), citing *New England Tel. & Tel. Co. v. State*, 113 N.H. at 95. The Commission has apparently rejected the Supreme Court's decision by ascribing to one formulaic methodology to calculate a reasonable rate of return on equity.

f. The Commission itself has held that reliance on one solitary financial measure is insufficient: "We agree with Staff that Commission precedent reflects the inclusion of dividends in order to produce an accurate return on equity estimate because ***'the use of any one measure of growth alone excludes information we believe investors consider in making their investment decisions.'*** *EnergyNorth Natural Gas, Inc.*, 78 NH PUC 117, 122 (1993)." *Verizon* at 63 (emphasis added). Just as the Commission has held that investors utilize more than one measure of growth in making their investment decisions, those same investors use multiple methodologies to determine a fair return on their equity capital. As noted earlier, the Society of Utility and Regulatory Financial Analysts' training manual confirms this, "Investors clearly do not subscribe to any singular method, nor does the stock price reflect the application of any one single method by investors."

g. Notwithstanding the overwhelming evidence that use of one methodology is both technically and legally incorrect, and the Commission's own admonition that it should not disregard information used by investors when they make their investment decisions, the Order erroneously continues the Commission's precedent of calculating a regulated utility's cost of equity capital using only the multi-stage DCF method. As more fully discussed in Paragraph 11 below, the error of using a single methodology was exacerbated in this case because the DCF methodology calculation was based on inputs that were unreasonable and yielded results that were irrational. The Commission's decision in this regard is unlawful, unreasonable and arbitrary.

h. As quoted earlier, in addition to the multi-stage DCF methodology solely relied upon by the Commission, the Order indicates "There are other valid methods as well, and this Commission has recognized that such methods may be used as a test of reasonableness to compare to the DCF result." Order at 34. It is noteworthy that Staff witness Ms. Sirois did perform a risk premium analysis to estimate the return on equity for the Company. Ex. 17 at 15-17. She testified that, "Using the Risk Premium analysis, I calculated an average return on equity of 9.82 percent." *Id.* at 17. Although the Order pays lip-service to the use of other valid methodologies "as a test of reasonableness to compare to the DCF result," it is apparent that Ms. Sirois's Risk Premium testimony was ignored by the Commission as the base return set forth in the Order of 9.42% was the exact number produced formulaically by the DCF methodology.

11. The return on equity set forth in the Order is unjust, unreasonable and unlawful because it was the result of an exact, mathematical calculation without the necessary use of reasonable judgment.[23] Furthermore, the calculations were performed outside the record, thereby abridging the Company's due process rights in that there was no ability to challenge the assumptions and data that formed the basis for the Order's end result.

a. Immediately following the issuance of the Order on June 8th, the Company requested that the Commission Staff provide the data and calculations that were used to arrive at the final result of 9.42%. On June 21, 2005, the Commission's Secretary forwarded "the inputs and the mathematical calculations relating to the return on equity determined in Order No. 24,473." (hereafter, the "Workpapers").[24] Attachment 4 to these Workpapers is captioned "DCF ROE w/ Hill's Sample and Sirois Method." The final number on Attachment 4, the "average" "3-st DCF ROE, %" is the precise 9.42% result adopted by the Order.

[23] *New England Tel. & Tel. Co. v. State*, 113 N.H. at 95.

[24] Secretarial letter dated June 21, 2005.

b. The Workpapers evidence that the Order indeed relied upon one single methodology (the multi-stage DCF methodology) to arrive at its end result. The Order states, "Our rate of return on equity, thus, is derived using the proxy group developed by Mr. Hill, the expected dividend yield and growth rate derived from the three-stage DCF methodology, as explained above, resulting in a rate of return on equity of 9.42 percent. We adjust this result for generation risk by adding 21 basis points, for a final return on equity of 9.63 percent for generation assets." Order, at p. 41.

c. The 9.42% return for a vertically-integrated operation that is the basis for the Order's final result is the exact result of a mathematical calculation based upon one particular theory, without the use of independent judgment. The 9.42% figure is based upon both extrinsic evidence and calculations that were not subject to discovery or cross-examination of the parties.

d. The 9.42% return set forth in the Order is clearly the "mathematically precise rate of return" rejected by the N.H. Supreme Court in *LUCC* and *New England Tel. & Tel.* It changes the art of ratemaking into an exact science,[25] and fails to consider returns being earned by companies with commensurate risks, the need to exercise judgment in the reasonableness of input data, the results of other widely accepted methodologies, and the performance of the Company's management in the operation of its generating business. The end result of the Order is a return on equity that falls well below the Constitutional zone of reasonableness.

e. After reviewing the information contained in the Workpapers, the Company cannot replicate the calculations leading to the 9.42% result. One possibility for this is that some of the input data is aberrant and therefore the result cannot be reasonably relied upon. In the Order, the Commission determined that it would apply Ms. Sirois's three-stage methodology. Order at p. 39. "Our calculations, then, use Mr. Hill's proxy group, incorporate the dividend yield derived from the

[25] "Although ringing of mathematical precision, the calculation of a just and reasonable rate is less a science than an art." *Public Service Co. v. FERC,* 832 F.2d 1201, 1206 (10th Cir., 1987).

30 day average of the daily high and low stock prices for the period ending May 17, 2005 and apply Ms. Sirois' three-stage methodology. As a result, the applicable DCF return on equity to use in this case is 9.42 percent." *Id.* The wholesale use of Mr. Hill's proxy group data in Ms. Sirois's methodology violates several of the fundamental criteria set forth by Ms. Sirois for the proper use of her methodology. In her pre-filed testimony, Ms. Sirois testified that her DCF three-stage methodology should only include "companies with positive forecasts of dividends per share (DPS) and earnings per share (EPS) growth rates over the next five years and positive historical DPS and EPS growth rates over the past five years." Ex. 17 at p. 9. These criteria are rational and based upon good professional judgment, and were not challenged by any of the parties to this proceeding. Nonetheless, the Workpapers clearly show that when the data for Mr. Hill's proxy group of companies was arbitrarily inserted into Ms. Sirois's equations, some of the results violated her criteria for the validity of her methodology. Attachment 3 of the Workpapers entitled "Growth Rates" reveals that eight of the twelve companies had <u>negative</u> growth rate, thereby violating Ms. Sirois's requirement of positive growth rates for the past five years. In addition, the data used by the Commission to calculate the 9.42% result has other anomalous data. For example, Attachment 3 to the Workpapers indicates that several of the companies used in the calculation of the proper ROE for PSNH would have overall <u>negative</u> earnings per share growth rates (column g), but would simultaneously have robust <u>positive</u> overall dividends per share growth (column h). Illustrative of this is PNM Resources - - the calculations indicate it would have an overall <u>decline</u> in earnings per share of 2.62%, but would have nearly a <u>7% increase</u> in dividends per share. A company displaying this type of behavior is one headed for insolvency. Use of anomalous data such as this is nonsensical and violates one of Ms. Sirois's basic reasonableness criteria.[26] In addition, the three-stage model found an equity risk premium of only 130 basis

[26] These irrational results would have been eliminated if conventional statistics tests had been applied to the regression equations. Those tests would have demonstrated the need to reject that data.

points in the first five years, an amount well below what any of the experts deemed reasonable. The computer programming saying of "garbage in/garbage out" is applicable here - - bad data input into a mathematical formula produces a bad result, even if the arithmetic is performed correctly. The Order reached an arbitrary, purely mathematical result in its rejection of the recommendations of the two most experienced witnesses, instead adopting the methodology of the remaining witness, while simultaneously ignoring that witness's own requirements and restrictions on the use of her methodology.

f. Under the Federal and State Constitutions' due processes clauses, the Company is entitled to a rehearing of the Order to allow it the opportunity to challenge the off-the-record calculations relied upon by the Commission. Assuming, *arguendo*, that the use of only the three-stage DCF methodology for the determination of a regulated utility's return on equity was legally permissible, the utility must have the opportunity to review the data that goes into the "black box" and to challenge the inclusion of unreasonable data.

g. "That [a utility] has an interest subject to the protection of due process is not in dispute, for this court has recognized a public utility's entitlement to a reasonable rate of return through its rates. *See New England Tel. & Tel. Co. v. State*, 113 N.H. 92, 95, 302 A.2d 814, 817 (1973)." *Appeal of Concord Steam Corp,*, 130 N.H. 422, 428 (1988). In *Concord Steam*, the Court continued:

> While due process in administrative proceedings is a flexible standard, this court long has recognized that the PUC has important quasi-judicial duties, and we therefore require the PUC's "meticulous compliance" with the constitutional mandate where the agency acts in its adjudicative capacity, implicating private rights, rather than in its rule-making capacity. *Appeal of Public Serv. Co. of N.H.*,122 N.H. 1062, 1073, 454 A.2d 435, 442 (1982). The PUC's due process obligation is apparent, moreover, in the statute delineating the agency's broad investigative authority, *see* RSA 365:5 and :19, 378:5, and in the provisions of the Administrative Procedure Act, *see* RSA 541-A:16, :18

*Id.*

The Court held that, "In making conclusive findings without affording the [utility] a meaningful opportunity to be heard, the PUC thus failed to satisfy its obligation of meticulous compliance with the requirements of due process. *See Appeal of Public Serv. Co. of N.H.*, 122 N.H. at 1073, 454 A.2d at 442." *Id.* at 429.

h. As in the *Concord Steam Corp.* case, PSNH "had no reason to offer, and did not offer, the objections or evidence"[27] relating to the propriety of the use of data from Mr. Hill's proxy group companies in Ms. Sirois's differing methodology. Therefore, PSNH's due process rights under the due process clauses of the Federal and State Constitutions were violated by the Commission's Order.

i. The Order also violates the requirements of the state's Administrative Procedures Act, RSA Chapter 541-A. RSA 541-A:31, VIII requires, "Findings of fact shall be based exclusively on the evidence and on matters officially noticed in accordance with RSA 541-A:33, V." The Order's finding that "the applicable DCF return on equity to use in this case is 9.42 percent"[28] is based on extrinsic data and calculations outside of the evidence of record. PSNH is entitled to a rehearing based upon this violation of the Administrative Procedures Act. This is not a case where the Commission relied upon its own expertise or the expertise of its staff.[29] Instead, its decision is precisely the result of new data and a new set of calculations that were never included as part of the evidence of record.

j. As evidenced by the use of input data that violates standards expressed in the testimony of its own Staff witness, the Order is based upon an arbitrary and unreasonable calculation, and not upon the expertise of the Commission or its Staff. The Workpapers also reveal that although the listing of companies from Mr. Hill's proxy group was used in the calculation of the Order's result, the actual data used was different. Column (b) of Attachment 4 of the Workpapers notes that the "Average Stock Price" used by the Commission to calculate its return was

[27] *Id.*

[28] Order at p. 39.

[29] *See, Granite State Alarm, Inc. v. New England Telephone & Telegraph Co.*, 111 N.H. 235 (1971); *New England Telephone & Telegraph Co. v. State*, 113 N.H. 92 (1973).

the "Average of daily high and low stock prices from April 18, 2005 to May 17, 2005 see Attachment 1." Mr. Hill's testimony was due and filed in this proceeding on April 20, 2005; therefore, his data could not have included stock prices through May 17, 2005.[30] Similarly, there are other differences between the data in the record and the information used by the Commission to calculate its 9.42% result. For example, the Value Line forecast earnings per share growth rates and dividend growth rates depicted on Attachment 3 of the Workpapers (columns e and f) are not the same as the Value Line data included in Schedule 4, page 2 of Mr. Hill's testimony (Exhibit 14). Hence, the Commission's finding that 9.42% was the proper return is based upon extrinsic factual evidence that is not part of the record.[31]

k. Contrary to the state Supreme Court's decisions in *Legislative Utility Consumers' Council v. Granite State Electric Co.*, 119 N.H. 359 (1979) and *New England Tel. & Tel. Co. v. State*, 113 N.H. 92 (1973), the Workpapers make it abundantly clear that in reaching the result set forth in the Order, the Commission has reduced ratemaking to an exact science by adopting a mathematically precise rate of return that can be produced by a competently programmed computer, without the requisite reliance upon judgment, evidence of record, comparable returns of companies facing similar risks, consideration of the risks facing the Company, and recognition of superior management efforts made by the Company.

12. The Order produces an arbitrary, unjust and unreasonable result because it fails to compensate the Company's investors for the risks they assume when they lend to the Company and buy its stock. *Appeal of Public Service Co. of New Hampshire*, 130 N.H. 748, 751 (1988). For example, the Order merely gives passing reference to the anti-CWIP statutes (RSA 378:28 and RSA 378:30-a). In addition, the Order grossly contorts the risk to investors of cost disallowances as the result of imprudence.

[30] The Order acknowledges that the Commission relied upon factual matters not contained in the evidence of record, "Our calculations, then, … incorporate the dividend yield derived from the 30 day average of the daily high and low stock prices for the period ending May 17, 2005…." Order, p. 38.

a. The Supreme Court has unequivocally directed that a company's investors are entitled to a compensatory return reflecting all risks they assume. *Id.* Specifically included as identified amongst these risks are those created by the state's prohibition on the recovery of construction work in progress ("CWIP").

> The anti-CWIP statute, for example, places the entire risk of loss from an uncompleted plant on the company's investors, *Petition of Public Serv. Co. of N.H.*, 125 N.H. 595, 484 A.2d 1139 (1984), and the same is true when a plant has been completed but never placed in operation, *Petition of Public Serv. Co. of N.H.*, 130 N.H. at 276, 539 A.2d at 267--68. ***The "constitutional consequence of this type of risk allocation is that those who bear the risk must be compensated by a return on their investment that reflects the risk that the statute places upon them***." *Id.* at 275, 539 A.2d at 269.

*Appeal of Public Service Co. of New Hampshire*, 130 N.H. at 751 (emphasis added).

b. The Order rejects the anti-CWIP risk which the Supreme Court has expressly identified and for which that Court expressly requires compensation. Regarding the anti-CWIP risk, the Order merely states that investors' "exposure to disallowances under RSA 378:30-a, the anti-CWIP statute, is not unique to New Hampshire." Order at 40. Perhaps this rejection of the anti-CWIP risk is the result of Commission Staff's views on this subject expressed during the hearing. Staff Counsel clearly intimated the opinion that there is <u>no</u> risk to investors caused by the anti-CWIP law: "I just want to state for the record that Staff is not conceding, this is a legal issue, that there is any risk to this company as a result of the anti-CWIP statute." Transcript, Day II, p. 112.

c. The issue of the impact of the anti-CWIP statute piqued the curiosity of Commissioner Harrington, spurring his own personal inquiry into this risk to investors. He asked whether the anti-CWIP restriction placed additional risk on PSNH's investors. In what PSNH views as a misstatement of the law, the response of the Staff witness to this question was, "In this case, through the

[31] Use of information different than what is in the record evidence opens up a Pandora 's Box of things that have changed, such as PSNH's bond ratings downgrade by Standard & Poor's from BBB+ to BBB on May 27, 2005.

Transition and Default Service rate mechanism, where they would be able to recover the costs associated with providing Transition and Default Service, in which expenditures on mercury abatement technologies, it's my understanding that those would be recovered, provided that they are prudent." The response fails to address the specific anti-CWIP risk recognized and addressed by the New Hampshire Supreme Court in the 1988 *Appeal of Public Service Co. of New Hampshire* decision as quoted above.

d. In closing, Staff Counsel took the position that the cost recovery provisions of the more recent RSA 369-B:3-a makes the effect of the anti-CWIP restrictions contained in RSA 378:28 and RSA 378:30-a radically different than in the past. Transcript, Day II, p. 212-3. PSNH disagrees with this view of the state of the law. Notwithstanding the existence of a Commission-approved cost recovery methodology pursuant to RSA 369-B:3, barring an implied repeal of the anti-CWIP law, not one penny of the Company's investment in a generating asset may actually be recovered until that asset is completed and used and useful in the provision of utility service. Since the law is clear that such implied repeals of statutes is disfavored, and since RSA 369-B:3-a and RSAs 378:28 and :30-a may be interpreted in a manner whereby they are all given effect, it is doubtful that the anti-CWIP risk addressed by the Supreme Court has been eliminated.[32]

e. The Order similarly trivializes the risk to equity investors of cost recovery disallowance due to the possibility that the Company's actions may be deemed imprudent. "[T]hough PSNH argued it is risky because it is subject to disallowance for imprudence, the record showed that imprudence findings have been no more than $6,000 related to PSNH's fossil or hydropower generation

[32] "'When interpreting two statutes which deal with a similar subject matter, we will construe them so that they do not contradict each other, and so that they will lead to reasonable results and effectuate the legislative purpose of the statute.' State v. Farrow, 140 N.H. 473, 475, 667 A.2d 1029, 1031 (1995) (quotation omitted). We construe the statutes as consistent with each other '[w]here reasonably possible.' State v. Philbrick, 127 N.H. 353, 356, 499 A.2d 1341, 1343 (1985)." *In re: N.H. Public Util. Commission*, 143 N.H. 233, 240 (1998). "Because a reasonable construction of the two acts taken together can be found, this court will not find that there has been an implied repeal. The doctrine of implied repeal is disfavored in this State, and will not be found without evidence of convincing force. *Board of Selectmen v. Planning Bd*., 118 N.H 150, 152--53, 383 A.2d 1122, 1124 (1978)." *Arnold v. Manchester*, 119 N.H. 859, 863 (1979).

assets since May 1, 2001. Exh. 15. PSNH, therefore, faces less risk than is normally the case for generation investments of vertically integrated electric utilities." This finding in the Order is completely contrary to Supreme Court precedents. Instead of recognizing that the risk of cost recovery disallowance is indeed one of the risks that the Company's investors face and providing appropriate compensation therefore,[33] the Commission has used these factors to reduce the Company's return! This "no good deed goes unpunished" philosophy is unreasonable, arbitrary, unjust and contrary to myriad judicial decisions. The risk of investors being precluded from recovering their costs due to prudence disallowances is exacerbated in New Hampshire, where such disallowances can and have been made even in the absence of management causation: "Even in the absence of 'any pervasive pattern of mismanagement', employee negligence causing an outage should be imputed to the utility, as the law of agency applies to utilities." *Re Public Service Co. of New Hampshire,* 76 NHPUC 645 (1991). The Commission recently required PSNH to shoulder some of the risk of the Northern Wood Power Project's modification to the Schiller Generating Station to allow the burning of wood chips as fuel.[34] As noted earlier, "***The 'constitutional consequence of this type of risk allocation is that those who bear the risk must be compensated by a return on their investment that reflects the risk that the statute places upon them***.' *Appeal of Public Service Co. of New Hampshire,* 130 N.H. at 751 (emphasis added). Therefore, the Order is arbitrary, unjust, unreasonable and unconstitutional as it fails to compensate investors for the risks placed upon them by statute and New Hampshire's regulatory regimen.

13. The Order produces a result that demonstrates a departure of the Commission from its statutory duty as arbiter under RSA 363:17-a.

[33] *Appeal of Public Service Co. of New Hampshire,* 130 N.H. 748 (1988).

[34] "In our judgment, in order for this modification to be in the public interest of PSNH ratepayers under RSA 369-B:3-a there must be a sharing of the risk that revenues will be insufficient to cover project costs." *Public Service Company of New Hampshire*, Docket No. DE 03-166, Order No. 24,276 (February 6, 2004), *slip op.* at 63.

a. RSA 363:17-a reads:

> **363:17-a Commission as Arbiter. –** The commission shall be the arbiter between the interests of the customer and the interests of the regulated utilities as provided by this title and all powers and duties provided to the commission by RSA 363 or any other provisions of this title shall be exercised in a manner consistent with the provisions of this section

"RSA 363:17-a provides that the commission must serve as 'the arbiter between the interests of the customer and the interests of the regulated utilities.' An 'arbiter' is a 'person with power to decide a dispute: judge.' WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 99 (9th ed. 1983)." *Appeal of CLF*, 127 N.H. at 654. The Commission's statutory duty to act as arbiter is significantly different than the advocacy role imposed by statute on the Office of Consumer Advocate by RSA 363:28, II.[35] The Commission's administrative rules echo the statutory requirement: "Puc 101.01 Purpose Statement. The primary purpose of the commission is to act as the arbiter between the interests of the customer and the interests of the regulated utility."

b. The Commission has not faithfully fulfilled its duty as arbiter, as demonstrated by the Order's attempt to award a return on equity capital to PSNH at what the Commission thought was the barest minimum lawful amount. Not only did the Commission not actually award a compensatory return within the zone of reasonableness, but it also did not award a just and reasonable return as required by statute by failing to consider the risks investors are exposed to, the extraordinary management and stewardship of the generation business that the Company has provided, and the returns being authorized for companies with commensurate risk. Instead, it relied upon facts that were not in the evidence of record and on anecdotal information.

c. The Commission's failure to fulfill its duty as arbiter is also displayed by its decision to rely solely on one single methodology to set the return on equity,

[35] "The consumer advocate shall have the power and duty to …represent the interests of such residential utility consumers." RSA 363:28, II.

contrary to the overwhelming evidence of record to the contrary including the testimony of OCA witness Hill, PSNH witness Dr. Morin, the recommendations of the Society of Utility and Regulatory Financial Analysts, the practice of the majority of utility regulators across the United States, and past decisions of the New Hampshire Supreme Court

d. As arbiter, the Commission has the duties and responsibilities of a judge. It performs a quasi-judicial function in contested adjudicative hearings, such as this proceeding. NH Admin Rules Part Puc 103.01. "In setting rates, a regulatory commission follows a process of identifying consumer and producer interests competing for recognition, with an ultimate goal of striking a fair balance or accommodation between them, to be reflected in charges to customers that may be described as just and reasonable both to the customer and to the utility." *Appeal of Public Service Co. of New Hampshire*, 130 N.H. 748, 750 (1988).

e. The deficiency in the Commission's performance of its duties as arbiter between the interests of customers and the interests of PSNH is also demonstrated by the disproportionate effect its decision would have on the Company versus retail consumers. The adverse impact on the Company of a reduction in the ROE is twenty times the benefit of any such reduction to retail consumers.[36] This disparity in the impact of the ultimate decision should have been considered in the determination of what return on equity is just and reasonable. Given the 20-to-1 disproportionate impact on the Company of the Commission's decision, a balancing of the equities requires a much more significant basis before imposing a substandard return.

f. Just as a judge is bound to follow lawful precedents from superior state and federal courts, the Commission, in its quasi-judicial role as arbiter, has the same responsibility. The Commission's failure to set a return on equity capital for PSNH's generation business which meets Constitutional and legal standards set forth by the United States Supreme Court and the New Hampshire Supreme Court

[36] Transcript, Day II, p. 102-3.

amply demonstrate the Commission's failure to fulfill its duty to act as arbiter. The resulting unreasonable, unlawful, unjust and arbitrary decision set forth in the Order demands rehearing in a manner consistent with the Commission's duty.

## CONCLUSION

PSNH respectfully urges the Commission to grant rehearing of its Order to reconsider its decision and to establish a return on equity capital for the Company's generation assets that is well-within the "zone of reasonableness" as required by law. United States and New Hampshire Supreme Court precedents require that this Commission award a return commensurate with the returns on investments in other enterprises having corresponding risk. The Order ignores that requirement, setting a return on equity capital that is below the allowed equity returns for the vertically-integrated or distribution operations of every company of similar risk identified by OCA and Staff. The record evidence demonstrates that the average allowed return on equity for electric distribution / vertically integrated companies of similar risk selected by the witnesses for the OCA and Staff is 11.34%; the average allowed return on equity for electric distribution / vertically integrated companies awarded during the first quarter of this year is 10.44%; and, the return on equity allowed by the FERC for reliability-must-run generation located in New England is 10.88%. The Company's equity investors are constitutionally entitled to a return commensurate with the returns allowed for these similar companies, as adjusted to reflect the greater risks inherent in generation operations.

Moreover, New Hampshire statutes require more than this Constitutional minimum return – the Commission, in its role as arbiter, is required to consider a just and reasonable return somewhere within the zone of reasonableness, not at the rock-bottom amount. The Company's management has demonstrated a record of operation, maintenance, and stewardship of the generation business that has produced significant economic benefits to retail consumers at the expense of shareholders and which warrants a return on equity well above the barest minimum bound of the zone. Without such consideration, shareholders receive absolutely no incentive to strive for such excellence, as all the benefits of those efforts flow directly and solely to retail customers. Clearly, investors should not be "punished" for historically avoiding imprudent operations; they should be rewarded by recognition of both the risks of possible disallowances as well as for operational excellence exhibited by the Company's management. Similarly, the use of shareholder dollars to avoid the enactment of legislation that would unreasonably create significant additional costs to customers must also be recognized and rewarded.

Just as there is a "zone of reasonableness" for the establishment of an appropriate return on equity for regulated utilities, there is a similar "zone of reasonableness" for those utilities' investments of equity capital in their New Hampshire utility systems. The Commission's decision to award minimal, unreasonable, unjust and arbitrary returns will negatively affect the level of capital expenditures that could be made in this state. Only when the Commission awards a fair and compensatory return, which acknowledges and encourages superlative management and the use of shareholder dollars to protect the interests of retail consumers, will management be able to increase capital investment in New Hampshire while fulfilling its fiduciary duty to shareholders.

For the reasons detailed herein, PSNH respectfully requests that the Commission grant this Motion for Rehearing, reconsider and amend its Order No. 23,473, and order such further relief as may be just and reasonable.

Respectfully submitted this 7th day of July, 2005.

**PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE**

By:____________________________________

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# TABLE OF AUTHORITIES

## CASES

## STATUTES



## RULES

**Certificate of Service**

I hereby certify that copies of the Motion have been served this 7th day of July, 2005, upon parties granted full intervenor status in this docket pursuant to the requirements of Rule Puc 202.18(d).

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